No. 71-1169

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

MOBIL OIL CORPORATION,
Petitioner,

v.

CARL F. MATZEN, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

ROBERT D. HAWORTH
Mobil Oil Corporation
P.O. Box 1774
Houston, Texas 77001

DONALD G. CANUTESON
Mobil Oil Corporation
P.O. Box 900
Dallas, Texas 75221

CARROLL L. GILLIAM
PHILIP R. EHRENKRANZ
1730 M Street, N.W.
Washington, D.C. 20036
Counsel for Petitioner

Of Counsel:

GROVE, JASKIEWICZ
AND GILLIAM
1730 M Street, N.W.
Washington, D.C. 20036
March 13, 1972

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Mobil Oil Corporation (Mobil) petitions for a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit entered in this case on December 17, 1971.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix C, pp. 15-40) is not yet reported. The opinion and orders of the Federal Power Commission (Appendix D, pp. 41-80) are reported at 42 FPC 164-187. The opinion of the

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[1] The names of the Respondents are set forth in Appendix A to this Petition, which also indicates origin of the controversy as a purported class action in a Kansas State Court (Appendix A, pp. 1-10).

Hearing Examiner (Appendix D, pp. 81-108) is reported at 42 FPC 187-198.[2]

JURISDICTION

The Judgment of the Court of Appeals was entered on December 17, 1971 (Appendix B, pp. 11-14), and this petition is filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r (b).

QUESTIONS PRESENTED

1. Whether the Federal Power Commission has regulatory jurisdiction under the Natural Gas Act over the rates for payment for the royalty interest in natural gas sold in interstate commerce for resale.

2. Assuming the Commission has jurisdiction over such rates, whether the Commission erred in holding that royalty owners may be entitled to payments, retroactively and prospectively, based upon rates higher than those effective under Section 4 of the Natural Gas Act for producers whose filed rate schedules cover the royalty interests.

3. Whether the Court of Appeals erred in failing to remand the case to the Commission for further proceedings *if* (a) the record and the Commission opinion are deficient as to evidentiary predicates and findings to support Commission conclusions, and (b) there is inadequate support for Commission conclusions that exercise of jurisdiction is required to effectuate the purposes of the Natural Gas Act.

STATUTES INVOLVED

Sections 1(b), 2(6), 4(a), 4(c), 4(d), 4(e), 5(a) and 19(b) of the Natural Gas Act, 52 Stat. 821 (1938), as

[2] Under separate cover, Mobil is filing the Appendices to this Petition.

amended, 15 U.S.C. §§ 717-717w, are involved and are reproduced at Appendix E, pp. 109-113.

STATEMENT

The questions presented involve exercise by the Federal Power Commission (Commission) of jurisdiction under Section 1(b) of the Natural Gas Act (15 U.S.C § 717(b)) over the rates for royalty interests in natural gas sold in interstate commerce for resale, and implementation of that jurisdiction under Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717c and 717d.

After hearings, the Examiner and the Commission affirmed exercise of such jurisdiction for almost eighteen past years, but the Court of Appeals has reversed, holding the Commission is without jurisdiction, and such rates are to be fixed in collateral state or federal court litigation.

Suits in the Federal And State Courts

Since June 7, 1954, the date of the decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, the Commission has regulated the entire volume of natural gas sold in interstate commerce for resale to interstate pipelines in or near the fields of production. Under state law, the various interests in the total volume delivered from a given well are classified principally as "working" interests and as "royalty" interests. The working interest owner is a lessee under a lease granting the right to explore, drill for, produce, recover, and sell natural gas underlying lands covered by the lease. The same instrument generally reserves to the lessor, and his successors, "royalty" expressed by a percentage or fraction (*e.g.*, 1/8) of "proceeds" or "value" of the natural gas if, as and when produced and marketed.[3] Commission regulation has

[3] For a more extensive discussion of the nature of the "working" and "royalty" interests, see: Williams & Meyers, *Oil and Gas Law*, §§ 201, 202, 202.1, 202.2, 202.3, 203, 204.9, 301; Summers, *The Law*

applied to the entire stream of natural gas regardless of these classifications of interests under state law.

However, as the Commission implemented rate regulation, numerous suits were filed in State and Federal courts because of claims by royalty interest owners that the royalty interest is not controlled by Commission regulation, and that these owners are entitled to substantially higher unregulated "prices" or "market values" to be determined in the courts. More than 290 such suits are now pending in courts in Kansas, Oklahoma, and Texas. Such suits were the beginning of the present case.

Mobil is a producer engaged in hundreds of regulated sales of natural gas and is lessee under oil and gas leases in the giant Kansas Hugoton Field. With respect to sales in that field, Mobil has been named as defendant in suits brought in the Kansas courts by royalty owners attempting to recover substantial amounts based upon rates or "values" in excess of the effective rates under filings by Mobil after June 7, 1954 pursuant to Section 4 of the Act.[4]

While such suits against Mobil were pending, the Court of Appeals for the Fifth Circuit, in *J. M. Huber Corp.* v. *Denman*, 367 F.2d 104 (1966), held that the Commission had primary jurisdiction over the principal threshold issues raised in such cases, *i.e.*, whether Commission jurisdiction to regulate rates for natural gas sold in interstate commerce for resale includes the rates for the royalty interests in such gas, and whether owners of royalty interests are prohibited from recovery in collateral litigation on the basis of "values" in excess of

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of Oil and Gas, §§ 11 and 21; and Williams, Maxwell & Meyers, *Cases and Materials on the Law of Oil & Gas*, 1956, Introduction, pp. 13-28.

[4] The "effective rate" is the rate the producer is permitted to collect under Section 4. Such "effective rate" may be firm or subject to refund pending Commission decision on "reasonableness" under Section 4.

effective rates fixed under Sections 4 and 5 of the Act after June 7, 1954.

After the Fifth Circuit's decision, parties to that case filed with the Commission a petition for declaratory order seeking determination of the questions of Commission jurisdiction. Subsequently, Mobil, Western Natural Gas Company (Western), and Pan American Petroleum Corporation (now Amoco Production Company) (Amoco) filed complaints seeking determination of the same jurisdictional questions as applied to royalty interest owners then seeking recovery in state and federal courts on the basis of rates in excess of rates effective under filings with the Commission.

By orders of the Commission, all petitions and complaints raising these issues were consolidated for hearing. Pending Commission decision, proceedings in the state and federal courts then were stayed or otherwise held in abeyance.

Proceedings Before the Commission

Mobil filed its Complaint on October 24, 1966 against Carl F. Matzen, *et al.*, (Matzen, *et al.*). Therein, Mobil requested the Commission to exercise its primary jurisdiction over the issues of jurisdiction in controversies between Mobil and Matzen, *et al.*, concerning royalty payments for a number of past years and to be paid in the future. These controversies then included 283 individual suits and one class action with 14 named plaintiffs, all of which had been instituted by Matzen, *et al.* against Mobil in three courts of Kansas.[5] In such actions, Matzen, *et al.*, claim entitlement to royalty payments based upon alleged "market prices" or "market values" in the Kansas Hugoton Field up to 21 cents per Mcf, substantially in excess of rates effective after June 7, 1954 under Mobil's FPC Gas Rate Schedule Nos. 3, 281, and 282.

[5] According to Mobil's records, the "class" on whose behalf the class action was brought includes approximately 600 persons.

Mobil urged the Commission to enter an order, *inter alia*, (1) confirming its jurisdiction over Matzen, *et al.*, and (2) declaring that Matzen *et al.*, are entitled, on and after June 7, 1954, to royalty payments based *exclusively* upon the effective rates by final Commission actions applicable to the three relevant FPC Gas Rate Schedules under which the volume to which each royalty interest pertains is sold. The answer filed by Matzen, *et al.* alleged that the Commission did not have jurisdiction over such payments and could not grant the relief requested.

By order issued April 3, 1967, the Commission consolidated all similar complaints and petitions then pending for formal hearing. Subsequent procedures included the granting of leave to intervene to forty-two parties and a prehearing conference. Parties then were loosely grouped as the "proponents" of Commission jurisdiction (which included Mobil and other regulated producing companies, a number of Eastern Seaboard distribution companies, the Public Utilities Commission of the State of California, and the Federal Power Commission's Staff) and the "opponents" of jurisdiction (which included Matzen, *et al.*, the Land and Royalty Owners of Louisiana, the State of Texas, and intervening royalty owner associations and groups).

Evidence Before the Commission. Formal hearings were held before an Examiner on January 22-25, 1968. Extensive evidence was submitted by numerous parties.

Mobil's evidence included the contracts executed by Mobil and its predecessors under which the interests involved are delivered to two interstate pipelines, Commission certificates issued under Section 7 of the Act authorizing these sales, and all Commission orders which had accepted the contracts as rate schedules under the Act and otherwise controlled the rates since June 7, 1954. Mobil also presented witnesses explaining its method of computing royalty payments on the basis of the rates effective under the Act, of payment on the basis of sus-

pended rates only upon assurance of responsibility by the payee for any subsequent refunds ordered by the Commission, and of later adjustments on the basis of rates ultimately approved by final Commission action.

As to specific interests of Matzen, *et al.*, Mobil submitted evidence as to their claims in the Kansas courts; the nature of each of the interests of Matzen, *et al.*, under leases committed to the performance of the three gas sales contracts in the Kansas Hugoton Field; the clauses of leases providing computation and payment to Matzen, *et al.* if, as, and when natural gas is produced and marketed; and examples of Mobil's Gas Division Order under which the signer certifies his interest in natural gas delivered under the rate schedules on file with the Commission.

Mobil and other "proponents" of jurisdiction also showed that the jurisdictional issue did not involve the *initial* transaction of executing a lease, or various payments *prior* to production and sale of natural gas, such as "bonuses," "cash payments" and "delay rentals." The record ultimately focused upon (1) the presently existent economic interest of Matzen, *et al.*, in natural gas if, as, and when produced, as defined in terms of a fraction, such as one-eighth, of the total volume produced and sold; and (2) the payment and interest pertinent to the proceedings before the Commission, defined as the continuing entitlement to a "cents per mcf" payment for the interest in the natural gas as and when produced and sold to interstate purchasers.

Other evidence showed application of the Act to the royalty interest since 1954 and the application of Commission rate and certificate jurisdiction to the entire eight-eighths volume of natural gas delivered under a jurisdictional sale, consisting of the seven-eighths or similar fraction attributable to the net working interest, and the one-eighth or similar fraction attributable to the

royalty interest. In addition, Mobil's witnesses showed that the full eight-eighths production of natural gas delivered under jurisdictional sales had been so regulated; the mechanics under which it is now so regulated under the Commission's area rate method; and the financial impact if "values" claimed by Matzen, *et al.*, were substituted for the rates effective under the Act.

Other evidence of similar import was presented by other "proponents" of Commission jurisdiction. The record thus contained extensive evidence as to the exact nature of the interests of Matzen, *et al.*, and others involved, facts as to the Commission's exercise of jurisdiction since June 7, 1954, and a formula presented by a Mobil witness from which impact of claims for "values" in excess of the effective rate can be computed for any jurisdictional sale.

The Examiner's Decision. The Examiner's Decision recited the history of the court cases giving rise to the Commission proceedings and precisely defined the interest actually involved (Appendix D, p. 91):

> "The interest we are concerned with here is called royalty and is created by a reservation in an oil and gas lease in which the landowner grants to the lessee certain rights and privileges, such as, to explore, drill and produce oil and gas, and in the same instrument *reserves to himself, free from the expenses of production, a share in the oil and gas produced or the proceeds thereof.*" (Emphasis supplied)

The Examiner then set forth an extensive analysis of the record, contentions of the parties, and pertinent constructions of Section 1(b) of the Act. Therefrom, he found (Appendix D, p. 100):

> "The result of the leases here involved is that the interests of both the lessor and lessee in gas produced and sold accomplishes the transfer of natural gas in a continuous flow to an interstate pipeline company for resale in interstate commerce."

* * * *

> "By the terms of the lease the royalty owner has a continuing interest in production as the payment flows from acquisition by interstate pipelines of gas for resale for ultimate public consumption. The lessee must account to the lessor for his share of the volumes of gas produced and compensate the lessor for his retained fraction of the production."

The Examiner referred to the regulatory "gap" that would be left if Matzen, *et al.*, were correct; to the connection between the claims of Matzen, *et al.*, for higher, unregulated rates and the consumer interest in just and reasonable rates under the Act's standards; and to the expectation that the "unregulated market" price claimed by them is "higher than allowed under regulation by the Commission." (Appendix D, p. 102). He then concluded (Appendix D, p. 103):

> "Considering the volumes of gas that move in interstate commerce and the uncertainty of the price to be paid for the royalty interest, which has a direct and substantial effect on the price paid by the ultimate consumer, the Commission must now exercise its jurisdiction to insure the reasonableness of price for gas to the consumer."

The Examiner's conclusion was that no additional filing requirements were necessary, except that an owner seeking an increase above that received by a producer should apply to the Commission for the higher rate of payment, submitting any supporting "factual information." (Appendix D, pp. 106-107).

The Commission Decision. Exceptions were filed on issues of jurisdiction, controlling rates, and filing requirements. After briefs were filed and oral argument, the Commission issued its decision, denoted Opinion No. 562, on July 23, 1969 (Appendix D, pp. 41-80). The Commission first referred to the history of the *Denman* case and the numerous controversies giving rise to the complaints filed by Mobil, Western, and Amoco, and to the findings

and conclusions of the Examiner (Appendix D, pp. 48-50). The Commission noted various exceptions by "opponents" of its jurisdiction (Appendix D, p. 52):

> "In reply to these arguments the staff, producers, distributors, and the State of California point out that the mineral lease requires that the producer sell the gas as best he can and that in fact the royalty-payment provision of the lease is not operative until the gas is actually sold."

The Commission then found (Appendix D, p. 53):

> "The basic fact here is the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce. While that portion of the royalty contract on which the royalty owners focus, which results in payments prior to the production of gas, may well be nonjurisdictional under the decision in *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission of Indiana*, 337 U.S. 498 (1948), the remaining portion of the arrangement, which results in payment to the royalty holder based on the production of natural gas for sale in interstate commerce, seems to us plainly to be jurisdictional."

The Commission went on to note that the distinction it made between a nonjurisdictional payment and a jurisdictional payment to the same person was not "novel," and cited instances where a "nonsignatory non-operator" interest owner holding a percent interest in proceeds from a gas sale "will technically be a natural-gas company" even though the operator of the property makes all filings with the Commission (Appendix D, p. 53). The Commission rejected "Hornbook definitions or local decisions not applicable to the Natural Gas Act," and held (Appendix D, p. 54):

> "We conclude that if he has contracted to retain an economic interest in interstate sales, he has joined the other interest owners in such sales and he has

become a seller of natural gas and therefore a natural gas company."

The Commission then examined the nature of that "economic interest," and further noted that on the two prior "instances where the matter was before us we asserted jurisdiction," and that because producer filings since 1954 cover the interests of all "nonsignatory" parties or those selling on a percentage basis, there had been no reason to assert "special jurisdiction" over royalty interest holders prior to the court decision involving "market value" claims that gave rise to the instant proceedings. The Commission then concluded (Appendix D, p. 56):

> "The jurisdictional royalty interest has in effect been covered by the producer filing since 1954 and we see no reason why it should not continue to be covered by the producer filing."

As to the points raised by producers' exceptions, the Commission stated: "The producers in general believe that the royalty owner should be allowed no more for his percentage of gas than the finally effective rate which the producer has on file." The Commission thereupon denied this exception, declaring that (Appendix D, pp. 58-59):

> ". . . the royalty provisions of oil and gas leases constitute sales of natural gas for resale in interstate commerce subject to all of the provisions of the Natural Gas Act.
>
> "For regulatory purposes such sales are covered by filings of the producer-operators and payment by the producers to the royalty owners should be made as provided by the contractual provisions of each lease, except that in no event should the payment exceed the just and reasonable rates as fixed by the Commission under the Act."

Rehearing, thereafter, was denied by operation of law; seven petitions for review under Section 19(b) were filed; and all such petitions ultimately were transferred to the Court of Appeals for the District of Columbia Circuit.

The Court of Appeals Decision

The Court of Appeals summarized facts as to prior proceedings (including *J. M. Huber Corp.* v. *Denman*, 367 F.2d 104 (5th Cir. 1966)), and genesis of the cases before the Commission. The court then referred to the evidence on "industry practice with respect to oil and gas lease agreements," stating that such evidence was "well summarized" by the Examiner, and to the "basic fact" which the Commission found determinative of the jurisdictional issue, "the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce." (Appendix C, p. 21). The court then referred to Section 1(b) of the Act as the controlling statutory provision, stating that "[f]or jurisdiction to attach . . . the royalty owners must be held engaged in a 'sale in interstate commerce of natural gas for resale'" within the meaning of Section 1(b), and whether royalty owners are so engaged is a question which requires reference to Congressional intent (Appendix C, p. 22).

Despite the Commission's conclusions as to effective exercise of jurisdiction since 1954, the court then stated that the Act "has not heretofore been construed to apply to ordinary lessors," and that the intent of Congress cannot be determined by references to "State law decisions," but "must ultimately be ascertained in the light of regulatory purpose and objective." (Appendix C, pp. 22-23). Nevertheless, the court presumed that Congress used the term "sale" according to its "ordinary" sense, and citing *Burnet* v. *Harmel*, 287 U.S. 103 (1932), found it sufficient for this case that "the royalty owner is not considered, either in common parlance or in conceptions of state law decisions, to be engaged in any 'sale' of gas." (Appendix C, p. 24).

The court noted Commission reliance upon *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965) (the "*Rayne* case"), for conclusions that (a) such local law is not determinative of the meaning of the term

"sale" in the Act, and (b) lack of regulatory control over interests held by royalty owners would create a "regulatory gap." However, the court characterized that case as having "extended FPC jurisdiction over sales of certain leases, although the Act addresses itself . . . to sales of gas." (Appendix C, p. 26). The court then stated that while the *Rayne* case held that lease transfers there involved were the equivalent in economic effect to conventional sales, an "ordinary" lease is neither a "customary" sale, nor its equivalent in economic effect. In the court's view, "the significant fact for a sale in interstate commerce is interstate movement," which in the case of a "typical oil and gas lease," it found lacking (Appendix C, p. 28).

The court then described attributes of a "typical" oil and gas lease, characterized the Commission's "approach" as a theory under which jurisdiction would attach to a lessor upon execution of a lease by virtue of his retention of an economic interest in interstate sales, and rejected such conception by analogies to a "developer of a shopping center," a "patentee," an "owner of farmland," and an "owner of a mine," none of whom, according to the court, become "sellers" merely through an economic interest in the proceeds of a sale (Appendix C, pp. 29-30).

Against this background, the court declared the Commission's ruling "unsound" and stated:

> "We do not think a different result warranted or mandated on the ground that the purpose of the Act is to protect the ultimate beneficiaries against exploitation by natural gas companies. That was indeed the objective of Congress, see *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944). The FPC is to be commended for attempting to further that objective, but it is not sufficient justification upon which to base an expansion of the Act to activities clearly not within its terms." (Appendix C, p. 30).

As otherwise here relevant, the court further found as to the impact of higher prices for consumers, that the record was deficient in that there were "no findings concerning the extent or significance of market price contracts"; that the Commission opinion gave "no concrete indication of whether, in what circumstances, or to what extent, there may be an economically meaningful problem of 'market prices' in excess of ceilings"; but that litigation between producers and royalty owners "may come to involve substantial sums even if pursued so as to recover royalties based on ceilings higher than filed rates." (Appendix C, p. 32)

As to such litigation, the court's "inference" was drawn from the challenge by Mobil and other producers of the Commission's holding that a royalty owner is not limited to the rate filed by the producer. However, the court stated that the record did not focus "on what may be involved in the possibility of recovery of royalty calculated on the basis of 'market prices' higher than ceilings." (Appendix C, p. 33). Thereupon, the court found no "theoretical impediment" to producers being held on the basis of a contract to a royalty payment related to a base higher than the producers' filed rate; indicated it was not persuaded that the maintenance in state or Federal courts of lease controversies between royalty owners and lessees "will undercut the Federal regulatory system" (Appendix C, p. 35); and reversed the Commission decision.

No provision was made for remand to the Commission.

REASONS FOR GRANTING THE WRIT

On the issue of Commission jurisdiction, the decision below conflicts in principle with controlling rules of construction of the Natural Gas Act enunciated by this Court;[6] disposes of an issue of general applicability under

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[6] See *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965); *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

that statute which has not been previously considered by this Court; and erroneously decides federal questions now pending in numerous state and federal courts in a way which adversely affects all federally regulated producers of natural gas and, ultimately, all consumers of natural gas sold in interstate commerce for resale.

On the issue of the controlling ceiling rate for royalty interests, the Court of Appeals' conclusions are in conflict with the "filed rate" doctrine applied by this Court and the Courts of Appeals in construction of the Natural Gas Act and similar federal statutes;[7] and would undermine the method of determining natural gas producing industry "area rates" under principles affirmed by this Court.[8]

On all of these issues, the decision below also conflicts with governing principles for judicial review of the factual and evidentiary predicate for an agency's findings and conclusions as to agency jurisdiction;[9] conflicts with principles of this Court's decisions which require remand for further proceedings *if* the predicate of findings or of substantial evidence is deemed deficient by the reviewing court;[10] and thus raises important questions as to the proper application of Section 19(b) of the Natural Gas Act which should be reviewed by this Court.

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[7] See *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951); *Federal Power Commission* v. *Sunray DX Oil Co.*, 391 U.S. 9, 37-38 (1968).

[8] See *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

[9] See *Federal Power Commission* v. *Florida Power & Light Co.*, —— U.S. ——, 92 S. Ct. ——, 30 L. Ed. 2d 600 (1972).

[10] See *Federal Power Commission* v. *United Gas Pipe Line Co.*, 393 U.S. 71 (1968); *Regal Knitwear Co.* v. *National Labor Relations Board*, 324 U.S. 9, 13 (1944); *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 145 (1940); *Federal Trade Commission* v. *Sperry & Hutchinson Co.*, —— U.S. ——, 40 U.S. Law Week 4241, No. 70-70 (March 1, 1972).

1. The Reversal of the Commission's Decision as To Its Jurisdiction Conflicts with Controlling Principles for Construction of the Natural Gas Act and Presents Issues of Wide Applicability and Importance Which Should Be Reviewed by This Court.

Federal Power Commission regulation of sales of natural gas in the fields of production currently applies to more than 13,000,000 million cubic feet sold each year and controls revenues exceeding $2.2 billion per year.[11] Of these amounts, more than one-eighth are attributable to the royalty interests. The decisison below applies generally to this economic interest held by all private, nongovernmental owners in all sales of natural gas heretofore regulated by the Commission.

By reversing the Commission's exercise of jurisdiction over the royalty owners' economic interest, the Court of Appeals would bar application of Commission-prescribed rates as the ceiling applicable to that interest and would permit such owners to charge and collect on the basis of higher unregulated prices and "market values" determined by state and federal courts. The result is creation of a new, broad gap in federal regulation heretofore controlling all private interests in sales of natural gas in interstate commerce for resale, a gap through which royalty owners and others may now avoid Commission ceiling rates.

This result was reached through failure of the Court of Appeals to apply properly the controlling principles for construction of the Act set forth in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965). There, this Court held that determination of a jurisdic-

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[11] See "Sales by Producers of Natural Gas to Interstate Pipeline Companies 1969," Federal Power Commission, December, 1970, Preface page VI, Table A, Domestic Producers. Regulation of these sales, including the economic interests of royalty owners therein, commenced after *Phillips Petroleum Co.* v *Wisconsin*, 347 U.S. 672 (1954).

tional "sale" under the Natural Gas Act cannot be made dependent upon "technical concepts of local law," but turns upon "significant and determinative economic facts" (381 U.S. at 400-401). In this case, the Examiner and the Commission had properly applied this test, focusing precisely and only upon the royalty owners' continuing economic interest in natural gas if, as and when produced; the receipt of payment therefor only upon production and sale; and then only upon the basis of units of production and out of revenues from the sale of those units. Consistent with this Court's opinions, the Commission thus drew the required lines of jurisdiction with meticulous findings, *e.g.*,

> "The basic fact here is the effective retention by the royalty holders of a percentage interest in the gas sold in interstate commerce. While that portion of the royalty contract on which the royalty owners focus, which results in payments prior to the production of gas, may well be nonjurisdictional under the decision in *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission of Indiana*, 337 U.S. 498 1948), the remaining portion of the arrangement, which results in payment to the royalty holder based on the production of natural gas for sale in interstate commerce, seems to us plainly to be jurisdictional." (Appendix D, p. 53).

Consistent with this Court's opinions, the Commission had rejected Hornbook definitions or local decisions not applicable to the Natural Gas Act," pointing out that ". . . a 'natural-gas company' is a person engaged in the 'sale in interstate commerce of [natural] gas for resale' but whether his operations would be classified as a 'sale' under private law is not determinative, *UGI* v. *Continental Oil Co.*, 381 U.S. 392." (Appendix D, p. 54). By such a correct analysis, the Commission held,

> "We conclude that if he has contracted to retain an economic interest in interstate sales, he has joined the other interest owners in such sales and he has

become a seller of natural gas and therefore a natural gas company." (Appendix D, p. 54).

Reversing the Commission, the Court of Appeals noted the controlling principles, but actually reverted to concepts of "local" law in rejecting the Commission's analysis, findings, and conclusions. Instead of focusing on the "significant and determinative economic facts," the court blurred controlling distinctions and sought definitions outside of the considerations of the regulatory purpose and scope of the Natural Gas Act. The court *actually* treated the question as one of jurisdiction over a lease at time of execution, and sought to establish Congressional "intent" by references to lease of a "supermarket" in "a shopping center," patent licenses, tenant farming, mining of iron ore, and interpretation of a tax statute (Appendix C, pp. 29-30).[12] *Cf. Eastern Petroleum Co.* v. *Kerr-McGee Corp.*, 447 F.2d 569 (7th Cir. 1971).

The Court of Appeals' analysis thus is almost a mirror image of the approach to construction of the Act and the arguments rejected by this Court in *United Gas Improvement Co.* v. *Continental Oil Co.*, *supra*, which, up to the instant case, had been interpreted as barring just such constructions of the definitions in Section 2(6) of the Natural Gas Act. See *Continental Oil Co.* v. *Federal Power Commission*, 370 F. 2d 57 (5th Cir. 1966); *J. M. Huber Corp.* v. *Denman*, 367 F. 2d 104 (5th Cir. 1966); *Weymouth* v. *Colorado Interstate Gas Co.*, 367 F. 2d 84, 102 (5th Cir. 1966). This Court's opinion was noted but simply was not followed below.

The construction involved here applies to the "typical" lease and is an interpretation of the Act applicable to

[12] Significantly, the Court of Appeals relied upon a definition of "sale" in a tax case involving mining law, but failed to note that despite various classifications of the royalty owners' economic interest under state oil and gas law, the owner is entitled to percentage depletion under the Internal Revenue Code, just as are other sellers. See Williams & Meyers, *Oil and Gas Law*, §§ 201, 202, 203, 204.9, 301; *Whitehall Oil Co.* v. *Boagni*, 255 La. 67, 229 So. 2d 702 (1969).

all private royalty interests in all regulated sales of natural gas in the fields of production, as the Commission had recognized correctly. The question of whether the Commission-prescribed rate or an unregulated "market value," determined by the various courts, is to control already is pending in more than 290 cases in state and federal courts. If the opinion below should stand, additional suits against regulated sellers can be expected. Therefore, the ultimate result could be that the rate for one-eighth or more of the natural gas sold in interstate commerce for resale would move out of Commission control, to rise with local interpretations as to current "market prices" in the various states of production, to be imposed to control payments on "proceeds" leases and "market value" leases.

Impact of the construction below will fall directly on all producer-sellers, and indirectly on all consumers of natural gas. Under the "area rate" method of regulation,[13] the Commission has assumed payments to the owner of the royalty interest on bases no higher than the rate allowed by the Commission to all other interest owners. The rate for "flowing gas" has been fixed or tested by reference to producers' costs, and the rate for "new gas" has included an allowance for payments equal to, but no higher than, the "area rate." If producers are forced to pay the royalty interest owner on excessive bases higher than the Commission has so allowed in the past, the producers inevitably must seek rate increases; these increases then will follow the flow of gas from the fields of production, through pipeline rates, and local distribution company rates, straight to the bills to ultimate consumers of natural gas. With more than one-eighth of revenues in fields of production so exposed to the vagaries of construction of lease terms and "findings" of current "value" under state law, it is no exaggeration to say that if the opinion below stands, the impact on the

[13] See *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

chain of rate payers can rise to tens of millions of dollars in a matter of months.

A more immediate result will be that if the opinion below should become final, petitioners must seek immediate remand to the Commission of four "area rate" cases now on review and by which the Commission had fixed rates for more than 60 per cent of the natural gas moving in interstate commerce.[14] In determining costs to delimit "zones of reasonableness," to fix rates, and to assess acceptability of settlement agreements in two cases, the Commission used the costing process reviewed in *Permian*, fixed rates, and decided the cases on the assumption that its Opinion No. 562, reviewed and reversed below, was valid and controlling. However, if as the Court of Appeals concludes, all of these rates no longer control the economic interest of the royalty owner, then all area rate determinations by the Commission which are not yet final must be reconsidered by the Commission. Cost determinations, whether used to fix a "pinpoint" cost-based rate or merely to demark the limits of a "zone of reasonableness," will require upward adjustment to cover the claims of the royalty owners and new "values" controlling payments to them. All that has barred these claims to date, and the need to adjust all costs upward, has been Commission Opinion No. 562, which the court below would nullify.

In sum, the opinion below would reverse consistent regulatory treatment of the royalty interest since 1954 and is based on a reversion in principles controlling de-

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[14] Commission Opinion No. 586, pending *sub nom.* Hugoton-Anadarko Area Rate Case (People of the State of California v. FPC), No. 71-1036, Ninth Circuit; Opinion No. 595, pending *sub nom.* Texas Gulf Coast Area Rate Case (Public Service Commission of New York v. FPC), No. 71-1828, D.C. Circuit; Opinion No. 598, pending *sub nom.* Southern Louisiana Area Rate Case (Placid Oil Co. v. FPC), No. 71-2761, Fifth Circuit; and Opinion No. 607 (Other Southwest Area), pending *sub nom.*, Shell Oil v. FPC, No. 72-1114, Fifth Circuit.

cision and review of questions of jurisdiction under a federal regulatory statute.[15] The opinion notes but does not actually follow this Court's opinions, reverses the Commission on a question of jurisdiction directly affecting all producers of natural gas, and disposes of questions pending in numerous fora which, if decided as the court below would permit, mean unnecessary, excessive payments attributable to a heretofore regulated economic interest, and unnecessary, but inevitable, increases in natural gas rates. Questions of major public importance in the administration of the Natural Gas Act, therefore, are raised and should be reviewed by this Court.

2. Conclusions of the Court of Appeals and of the Commission as to the Controlling Ceiling Rate Conflict with the "Filed Rate" Doctrine under Decisions of This Court and the Courts of Appeals.

Before the Commission, three choices of the controlling, effective ceiling rate for the royalty interest were advocated: (1) the rates in effect on June 7, 1954 until lawfully changed under Section 4; or (2) the specific "filed rates" and rate increases filed by the well or plant operator, as lawfully changed from time to time after June 7, 1954 under orders effective and final under Section 4 of the Natural Gas Act; or (3) the "area rate," even if higher than such a "filed rate," applied retroactively and

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[15] Contrary to the opinion below, the Commission correctly found that it effectively has regulated the economic interest actually involved since 1954, and that continued regulation was consistent with and required by the purposes and regulatory objectives of the Act (Appendix D, p. 56). Conversely, the Court of Appeals substitutes the court's "findings" for the deference due these agency findings and conclusions, violating principles of *United Gas Improvement Co.* v. *Continental Oil Co., supra*, and the teaching of *Gray* v. *Powell*, 314 U.S. 402 (1941); *National Labor Relations Board* v. *Hearst Publications, Inc.*, 322 U.S. 111, 129-130 (1944); *Securities and Exchange Commission* v. *New England Electric System*, 384 U.S. 176 (1966); *First National Bank* v. *Dickinson*, 396 U.S. 122 (1969); and *United States* v. *Drum*, 368 U.S. 370, 375-376 (1962).

prospectively, once fixed by a Commission "area rate" decision applicable to the particular sale.

The Commission chose the latter (Appendix D, pp. 57-58), and Mobil and others sought review on the grounds that (1) such "area rates" frequently are higher than "filed rates" for past periods, and sometimes are higher than prices allowed under producers' long-term contracts dating from the 1950s and early 1960s; and (2) any retroactive application of "area rates" violated the "filed rate" doctrine and settled construction of the Act limiting such changes to prospective application only.

While reversing the Commission on jurisdiction, the Court of Appeals indicated its disagreement with the positions of both the producer-petitioners and the Commission below (Appendix C, pp. 32-35). The Court indicated its view that there was "no theoretical impediment" to producers being held on "the basis of contract" (Appendix C, pp. 33-34), stated that it was "puzzled" and "uneasy" as to the Commission's "conception" and "analysis," and ignored controlling constructions of Section 4.

Nevertheless, if as the Commission held, the interest is jurisdictional and controlled by operators' filings, then the *only* lawful rate is that which has been effective, from time to time, by proper filing of increases by the operators under Section 4, and there can be no retroactive increase of those rates solely for the royalty interest. Rates actually so effective in the past would apply equally to the benefit of all interest owners under the operators' filing, and a higher "area rate" could apply prospectively only and equally to all interest owners.

The views expressed by the Court of Appeals and the Commission's conclusion on the question conflict with the holdings that (1) there can be no retroactive changes of the rates made effective without suspension under Section 4 of the Natural Gas Act (*Federal Power Commission* v.

Hope Natural Gas Co., 320 U.S. 591 (1944)); and (2) the filing of rates and changes of rates in accordance with procedures such as those in Section 4 is the only means of establishing a legally effective rate, and final rates so established control in subsequent or collateral proceedings (*Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951); *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 339-340, 343 (1956)). The conclusions below thus also conflict with prior consistent application of this "filed rate" doctrine under the Natural Gas Act by the Fifth Circuit (*Socony Mobil Oil Co.* v. *Brooklyn Union Gas Co.*, 299 F. 2d 692, 694-695 (5th Cir.), cert. den., 371 U.S. 887 (1962)); the Third Circuit (*Shell Oil Co.* v. *Federal Power Commission*, 334 F. 2d 1002, 1009 (3rd Cir. 1964)); the Tenth Circuit (*Cities Service Gas Producing Co.* v. *Federal Power Commission*, 233 F. 2d 726, 730 (10th Cir. 1956)); and the District of Columbia Circuit (*Episcopal Theological Seminary* v. *Federal Power Commission*, 269 F. 2d 228, 233 (D.C. Cir.), cert. den., 361 U.S. 895 (1959)).

This issue also applies generally to all jurisdictional sales by producers and is the threshold question in resolving all of the controversies over the controlling ceiling rate under the Natural Gas Act. Therefore, with the issue of jurisdiction, the questions so raised should be reviewed by this Court.

3. The Court of Appeals Erroneously Rejected the Agency's Predicate for Its Conclusion That It Had Jurisdiction and, in Any Event, Should Have Remanded If the Court Concluded the Commission's Findings or Evidence Were Deficient.

As shown *supra*, the Court of Appeals rejected the Commission's findings and conclusions upon the "significant and determinative economic facts," upon the economic effect of the *part* of the lessor-lessee transaction held to be jurisdictional, and upon the construction required by

the regulatory purposes and objectives of the Act (Appendix C, pp. 28-34). In so doing, the court stepped outside of its role of review under Section 19(b) of the Act, particularly in so rejecting the formal findings of the Examiner and the Commission underlying the conclusion of jurisdiction. The errors thus are similar to those found by this Court in its review and reversal of a decision by the Fifth Circuit involving jurisdiction under the Federal Power Act in *Federal Power Commission* v. *Florida Power & Light Co.*, —— U.S. ——, 92 S.Ct. ——, 30 L.Ed. 2d 600 (1972).

Beyond this, if the Commission's findings and the evidence supporting those findings actually are deficient,[16] the proper course is a reversal and remand to the Commission. *Federal Power Commission* v. *United Gas Pipe Line Co.*, 393 U.S. 71 (1968); *Regal Knitwear Co.* v. *National Labor Relations Board*, 324 U.S. 9, 13 (1945); *Federal Communications Commission* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 145 (1940). This course should have been followed even if, in the view of the Court of Appeals, it was only laying bare "an error of law." *Federal Power Commission* v. *Idaho Power Co.*, 344 U.S. 17, 20 (1952).

The Court of Appeals also erred in substituting its views, based on wholly extraneous concepts such as those used in state mining law or shopping center development, for the Commission's findings and conclusions. Similarly, on the question of Congressional "intent," the court erred

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[16] We, of course, do not agree that there are any such deficiencies requiring or permitting reversal of the Commission under Section 19(b). On the merits, we would be prepared to show that the record, the findings, and the available materials as to Congressional intent all support the Commission's conclusions on jurisdiction, not those of the court below. Nevertheless, if this Court should conclude that the analysis, findings, or substantial evidence supporting the Commission's conclusions on the jurisdictional issue are defective, then we would urge that the proper course would be to set aside the opinions and orders on review and to remand for further agency proceedings.

in failing to refer to actual content of the record and cited materials pertinent to that question. Its analysis and process of review thus did not follow the strictures on "scope of review" applicable to proceedings under Section 19(b) of the Act. See *Permian Bason Area Rate Cases, supra.*

As in the *Florida Power & Light Co.* case, this case thus raises questions of the proper role of the court in review of an agency determination that it has jurisdiction. In this instance, findings involving "economic effect" and a rate regulatory program already operative for almost eighteen years have been overturned with no remand to the agency. Both the result and the process by which the Court of Appeals reached such a result thus present questions that should be reviewed by this Court.

4. The Decision Below Would Permit Diversion of Funds Needed to Alleviate a National Shortage of Natural Gas to Windfall Payments to Owners Who Bear No Costs.

The Commission has found that there is "a critical shortage of gas in the United States." [17] In the hope of alleviating that shortage, the Commission has taken a number of steps designed to increase the capital available to producers for exploration and development on existing leases and new leases, including allowance of higher rates as "incentives" for immediate and continued use of all available funds for these purposes.[18] The opinion below, however, is a major blow to that program.

The "royalty" owner bears no costs and does not engage in exploration and development. Owners of the working interests—the producer "operators"—bear the costs of

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[17] Commission Opinion No. 598, —— FPC —— (Issued July 16, 1971, p. 23 mimeo. ed.), on review *sub nom.* Southern Louisiana Area Rate Case (Placid Oil Co. v. FPC), No. 71-2761, Fifth Circuit.

[18] See, *e.g.*, opinions cited in fn. 14, *supra.*

production and must acquire and commit the capital needed for exploration and development. This risk capital is, in large measure, generated internally from revenues from current sales. Under the Commission's current method of fixing rates, the capital requirements, and the availability of funds, have been computed on the assumption that the royalty owners' share of those revenues will be based on rates at least no higher than the Commission-prescribed "area rates." Yet, the opinion below would permit courts in collateral actions to substitute their determinations of "current market value" as they see fit.[19]

As this happens, two results would follow, neither of which would be consistent with the purposes and regulatory objectives of the Natural Gas Act: (1) the increased rates for the royalty owners would require corresponding increases in producers', pipelines', and distributors' rates, with no resultant commitment of funds to the program to alleviate the gas shortage; or (2) to the extent that "lag" or other delay in rate increases causes producers or pipelines to absorb any of the excess payments to royalty owners, funds for exploration and development would have to be diverted to cover these payments. Since more than one-eighth of the revenues in fields of production are exposed by the opinion below, the ultimate result would be windfall payments to royalty owners with no corresponding benefit whatever to minimize the national shortage of natural gas.

These considerations were a part of the Commission's assessment of "economic" facts and the regulatory purposes involved. The Court of Appeals erroneously rejected those conclusions, exposing a national supply program to erosion in scores of state courts. The result cannot be reconciled with the Act or applicable principles of con-

[19] The record shows that at least one state court has already concluded that the royalty owner should be paid on the basis of "market value" even where a payment clause provides only for payment of a share of "proceeds."

struction of such a federal statute. In any event, the impact is such that early resolution of the questions presented to this Court is more than warranted.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

ROBERT D. HAWORTH
P.O. Box 1774
Houston, Texas 77001

DONALD G. CANUTESON
P.O. Box 900
Dallas, Texas 75221

CARROLL L. GILLIAM
PHILIP R. EHRENKRANZ
1730 M Street, N.W.
Washington, D.C. 20036

Attorneys for
Mobil Oil Corporation

Of Counsel:

GROVE, JASKIEWICZ
AND GILLIAM
1730 M Street, N.W.
Washington, D.C. 20036

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